



Economic Update

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Emerging Evidence Anticipates Stronger Growth, but Employment Lags

Following 3 years of slowdown, recession, and slow recovery, evidence is gradually emerging that the U.S. economy is on the verge of higher growth. Although data from labor markets and the manufacturing sector show continued sluggishness, other signs point to an improving economic outlook in the second half.

Recent signs pointing to higher growth include a rebound in the stock market, nascent signs of improvement in the manufacturing sector, higher nonmanufacturing business activity, improved consumer and business confidence, and significant additional tax relief for businesses and consumers beginning in the second half of this year.

Manufacturing and Employment Lag, But Other Signs Point Up

Much of the adverse economic performance of the past 3 years resulted from the substantial declines and stagnation in the stock market, manufacturing, and business investment -- all following on the heels of their run-up to inflated peaks in early- to mid-2000. Recent data are finally beginning to show that the U.S. economy is poised to move beyond these drags and return to sustained higher growth.

Employment situation: Labor markets continued to be sluggish in June, with the unemployment rate rising to 6.4 percent, nonfarm payroll employment falling by 30,000 jobs, and weekly claims for unemployment insurance remaining above 400,000.

- At 6.4 percent, the unemployment rate is at its highest level of the current phase of the business cycle and the highest since April 1994.
- The increase in the unemployment rate in June reflects the warning given in last month's *Economic Update*: even though "household" employment rose in June, an

increase in labor force participation and an increase in the total number of unemployed combined to result in an increase in the unemployment rate. These results are consistent with the view that increased optimism about the outlook for the economy encourages higher labor force participation -- individuals seeking work -- but prior to the job growth being able to absorb it.

- Declines in nonfarm payroll jobs have continued in recent months, but at modest amounts. Unemployment insurance [UI] claims continued around the 430,000 level; an improving employment picture would require UI claims falling significantly below 400,000.

Manufacturing: Some signs suggest the manufacturing sector is poised for stronger performance in coming months. The Institute for Supply Management's purchasing managers index [PMI] for manufacturing improved slightly in June, to 49.8, indicating that the manufacturing sector was essentially flat (a value of 50 is a neutral level consistent with the manufacturing sector neither expanding nor declining). Most components of the index, however, showed increases: new orders, production, prices, export orders, and imports were all expanding. Employment and inventories showed declines. Nonetheless, the current low level of inventories, coupled with the increase in orders, bodes well for future increases in production.

Other signs suggesting improvement include the following:

- Consumer confidence and sentiment have rebounded over the past 3 months following their lows preceding the Iraq conflict. Business confidence also is improving: the Conference Board's index of business executives' confidence rose to 60 in the second quarter, from 53 in the first quarter; it had fallen as low as 31 in the fourth quarter of 2000. The National Federation of Independent Business [NFIB] index of small business

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optimism rose in June to its highest level since November, and is now at a level consistent with sustained expansion.

- The Institute for Supply Management's nonmanufacturing (service sector) business activity index rose to 60.6 in June, its highest level since September 2000 – before the beginning of the recession.
- The stock market has registered significant gains in recent months, with the increase in the S&P500 during the second quarter its best quarterly performance since the fourth quarter of 1998. It appears the deflating of the late-1990s bubble may finally be past, with an improving outlook going forward.
- In contrast to other recessions, consumer spending has continued to grow throughout the recent recession and slow growth period. That helped to keep the recession relatively mild compared to other post-World War II recessions. Although households and consumers in the aggregate have faced slower income growth, a reduced tax burden from the tax relief of 2001 boosted consumers' "disposable income" – that is, after-tax income available for spending or saving. The additional tax relief from the recently enacted "jobs and growth" tax relief of 2003 will provide an additional boost to consumers' disposable income this year and next.
- In the past 2 years, the exchange value of the dollar has declined about 30 percent relative to the Euro, and about 15 percent relative to major currencies combined. The decline will aid U.S. manufacturers and export industries as the price of U.S. exports for foreign importers will fall; but the trade benefits could lag by a year or more.
- Low levels of interest rates – for both short-term and long-term interest rates – are continuing to help promote interest-sensitive spending, such as for consumer durable goods and housing. Housing starts and residential investment continue at or near record-high levels.

Blue Chip Outlook

Private forecasters expect that the U.S. economy will rise to a higher rate of growth – in the 3½-percent to 4-percent range – in the

second half of this year and throughout 2004 (see table with July Blue Chip projections). The unemployment rate is expected to gradually decline over the next year and a half. The July Blue Chip survey was conducted prior to the release of the June employment report which showed the increase in the unemployment rate to 6.4 percent. Next month's Blue Chip forecast likely will show a correspondingly higher unemployment rate projection (at least in the short run). The Blue Chip forecasters expect inflation and interest rates to stay relatively low, and then only rise gradually through next year.

The Blue Chip forecasters generally are optimistic about the outlook. On a special question, 73 percent of respondents said it was more likely that U.S. economic growth would "surprise on the upside" rather than on the "downside."

Policy Points: Tax Checks Being Mailed; Fed Chairman Greenspan to Testify

Tax relief from the "jobs and growth" package of 2003 is beginning to flow to taxpayers. Withholding changes have been put in place, and according to the Treasury Department are expected to reduce workers' taxes and put \$22 billion into the economy this year, and \$35 billion next year. In addition, taxpayers eligible for the child tax credits will receive checks in the mail in July or August totaling about \$14 billion. At an annual rate, the tax relief will amount to about 1¼ percent of GDP in the third quarter – representing a significant boost to the economy.

Fed Chairman Greenspan is scheduled to testify before House and Senate committees for the semiannual monetary policy report to Congress on 15 July and 16 July.

	Blue Chip Economic Outlook, July 2003							
	2003.1	2003.2	2003.3	2003.4	2004.1	2004.2	2004.3	2004.4
	History	Projection						
Real GDP Growth	1.4	1.9	3.6	3.8	3.9	3.8	3.7	3.5
Unemployment Rate	5.8	6.2	6.1	6.1	6.0	5.9	5.8	5.7
CPI Inflation	3.8	0.6	1.4	1.7	1.9	2.0	2.1	2.2
3-month Treasury Bill	1.2	1.1	1.0	1.0	1.1	1.4	1.7	2.1
10-year Treasury Note	3.9	3.6	3.6	3.7	3.9	4.1	4.4	4.6

Note: Data for unemployment rate and interest rates for 2003.2 are actual not projections.

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